FILED
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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1961

No. 524

RAYMOND L. SMITH, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

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Raymond I. Smith, Inc. hereby petitions for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit, to review its decision entered June 28, 1961, rehearing of which was denied on August 7, 1961.

DECISION BELOW

The opinion of the Court of Appeals is set forth in the appendix hereto. It is officially reported in 292 F. 2d 470.

It is unofficially reported in 61-2 USTC par. 9562 (C.C.H.) and 8 AFTR 2d 61-5119 (P-H).

The opinion of the Tax Court is set forth in the printed record (R 72-97). It is officially reported in 33 T.C. 141. It is also unofficially reported in CCH Tax Court Reporter as Decision 23,812.

JURISDICTIONAL STATEMENT

The decision below was rendered June 28, 1961 and was entered on the same day. A petition for rehearing was filed on July 19, 1961, and was denied without opinion on August 7, 1961.

Jurisdiction is conferred on this Court to review the decision below by 62 Statutes at Large 928 (United States Code, Title 28, Sec. 1254).

QUESTIONS PRESENTED

A. One group of questions presented involves the proper interpretation and application of provisions added by Congress in 1954 and 1955 to the Internal Revenue Codes of 1939 and 1954, intended to govern trials in the Tax Court of cases involving the penalty tax on accumulated corporate earnings imposed by Section 102 of the 1939 Code and Sections 531 et seq. of the 1954 Code. Briefly, these new provisions reversed "the burden of proof", if certain procedural steps were first taken, and placed it on the Commissioner of Internal Revenue instead of the taxpayer, "with respect to (the) allegation . . . . that all or any part of the earnings and profits

have been permitted to accumulate beyond the reasonable needs of the business".

The questions presented are these:

1. Are these provisions devoid of substantial effect on the basic question of intent, as the Tax Court has consistently held?

2. If the Tax Court is mistaken in this view, as the Court of Appeals held, should the appellate court speculate about what the Tax Court would have held had it understood where the burden of proof lay, or should it remand the case to the Tax Court for reconsideration with proper instructions concerning the burden of proof?

3. Are the questions of purpose of the accumulations and the justification for accumulations mixed questions of fact and law, as the Court of Appeals held, or questions of pure fact, as this Court has held?

B. A second group of questions involves the credit for accumulated earnings, provided for the first time by the 1954 Code. This credit consists of a specific exemption, and of a credit for earnings accumulated for reasonable needs of the business, and exists independently of the decision concerning the intent to minimize shareholder taxes. (Sec. 535(c).) The Commissioner has the burden of proof on the question of the reasonableness of the accumulation. (Sec. 534.)

4. In the computation of the credit for earnings accumulated for reasonable needs of the business can the intention of Congress to shift the burden of proof to the Commissioner be given effect by holding that the Commissioner has sustained his burden of proof where the

record is completely silent on the point which the trial court and the reviewing court both think critical?

5. The same question as that in question 4 is also presented in respect of the basic issue of purpose, where the Court of Appeals held that the Tax Court had incorrectly thought that the burden of proof was on the taxpayer, but the Court of Appeals nevertheless affirmed the Tax Court although the record is completely silent on a point both courts thought critical.

6. Is the intention of the Congress to shift the burden of proof to the Commissioner concerning the reasonableness of the accumulation given effect if the Commissioner can satisfy it by pointing to two circumstances necessarily present in each case of this sort, i.e., the fact that there are accumulated earnings, and the fact that the shareholder's taxes would have been greater than they were had the shareholder's income been increased by dividends from the corporation?

C. A series of questions is also presented about the legitimacy of the standards applied by the Tax Court on the substantive question of purpose.

7. Where a majority of the directors of a corporate taxpayer testify to the reasons which led them to decide against the declaration of dividends, and the Tax Court finds as a fact that the directors did believe that no dividends should be declared for the reasons given, can the Tax Court properly hold that the "purpose" of the corporate taxpayer differed from that of its directors?

8. Can accumulations be held unreasonable because they are insufficient without further accumulations to finance the entire projected program?

9. May the Tax Court properly adopt a standard for measuring the reasonableness of accumulations which required that a taxpayer establish that the profitability of the expansion of its business will be "proper"? This question comprehends both the propriety of the adoption of such a test and the propriety of placing the burden of proof on the taxpayer.

STATUTORY PROVISIONS INVOLVED

The statutes involved are lengthy and accordingly are set forth in the Appendix, infra, pp. i-iv, inclusive.

STATEMENT OF THE CASE

This case arose in the Tax Court by a petition having been filed within 90 days of the date of mailing a deficiency letter. (R. 10, 11.) The Tax Court decided two of the four years before it for petitioner, and an equal number of years for respondent. (R. 98-99.) Petitioner petitioned the Court of Appeals for review of the adverse portions of the decision within three months of the date of decision by the Tax Court. (R. 99, 101, 102.)

Petitioner is a Nevada corporation with its office and place of business in Reno, Nevada. It operates all the bars in Harolds Club, a legal gambling casino in Reno. The two corporations have no shareholders in common, although petitioner's shareholder is general manager of Harolds Club. (R. 73-75.)

Petitioner has no trade name of its own and operates its bars as if they were owned by Harolds Club, even to

using the name "Harolds Club" on the bar glasses and bottles. (R. 79, 91; cf. R. 75.) Petitioner early adopted the policy of using its funds to attract patrons to Harolds Club, that being the only way it could build patronage for itself. Thus petitioner purchased a large collection of old guns and western memorabilia and mounted it in Harolds Club near its bars. (R. 79-81.) This was held by the Tax Court to be a proper use of earnings in petitioner's business, not subjecting it to the penalty tax on accumulating earnings for the purpose of avoiding higher taxes on its shareholder. (R. 89, 91-92.) The Tax Court said of this:

> "The connection between Harolds Club and the petitioner is so close that the use of this material and the outside advertising,[1] all in the name of Harolds Club, also benefits the petitioner in proportion to the benefits received by Harolds Club." (R. 91.)

This policy also led petitioner to buy a motel, refurbish it, and operate it to house out-of-town patrons of Harolds Club. (R. 83-84.) The motel was on land well located for later development as a hotel-casino, but when petitioner sought to acquire neighboring properties in order to accumulate a land area large enough for this purpose it found that identification of the motel with Harolds Club had caused neighboring prices to go out of sight. (R. 84.) The Tax Court found that petitioner's accumulation of earnings in this motel did not subject it to the penalty tax because (R. 92):

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[1]Here the Tax Court was referring to the employment of one Stagg, former owner of the collection, to travel to fairs and the like and to advertise Harolds Club, all at petitioner's expense. (R. 80-81, 91.)

> "This transaction was closely connected and directly related to the business of the petitioner which in turn was closely tied in with the business of Harolds Club. It enabled the petitioner on behalf of itself and Harolds Club to provide at least some of their patrons with lodging accommodations at reasonable rates and the petitioner with profit and other advantages."

In late 1953 and early 1954 petitioner purchased some 348 acres of farm land near Reno, on the same highway approach to the city as its motel. Having insufficient available funds to pay the entire purchase price, petitioner borrowed much of it. (R. 85.) This land was well suited to use for a resort hotel-casino, similar to those existing near Las Vegas. Both petitioner's and Harolds Club's officers were aware at the time of the purchase that others were trying to buy land in this area for this purpose. (R. 86-87.) In any joint development along these lines, "petitioner was to operate all bars". (R. 87.) When plans were prepared the cost exceeded expectations and available funds and construction has not begun. (R. 87-88.)

The Tax Court held that petitioner was liable for the penalty tax for 1953 and 1954. (R. 97.) It stated: "The purchase of this land at such a large price for the stated purpose by Harolds Club might be one thing, but by the petitioner is quite another." (R. 93.) Although petitioner had duly and timely filed a statement of grounds and supporting facts to explain the accumulation of earnings (R. 26-40), no finding was made about this statement, nor was any reference made to it in the opinion of the Tax Court. The Court of Appeals found the statement suffi-

cient to shift the burden of proof under Sec. 534, 1954 Internal Revenue Code. (Appendix p. xii.) The Tax Court stated:

> "The petitioner, of course, has the ultimate burden of proof." (R. 96.)

The Court of Appeals disagreed. (Appendix, pp. xii-xiii.)

Petitioner claimed, for the year 1954, an accumulated earnings credit equal to its entire net earnings, under Section 535 (c) of the 1954 Code applicable to the 1954 Code. Under Sec. 534 of that Code the burden of proof on that issue was on respondent. The Tax Court said:

> "The petitioner has raised another issue relating to a credit under Section 535 (c)(1) of the Internal Revenue Code of 1954, but the Commissioner has not made any argument with respect to this contention in his briefs." (R. 73.)

Again, the Tax Court said:

> "The Commissioner in his brief ignores this contention . . ." (R. 97.)

The Tax Court sustained the Commissioner, nevertheless.

The Court of Appeals affirmed the Tax Court. Although agreeing with petitioner that the Tax Court had misplaced the burden of proof (Appendix, pp. xii-xiii), the Court of Appeals concluded that no harm had resulted largely because of a finding of the Tax Court, which it regarded as crucial, that the benefits petitioner could hope to derive from the hotel-casino were disproportionate to the size of the investment. (Appendix, pp. xv, xvi.) We contend that the record contains no evidence to support

this finding. The Court of Appeals also stated that the conclusion below was a mixed question of fact and law "and we do not believe that the Tax Court's views as to burden of proof played any part in the determination so made." (Appendix, p. xiv.)

ARGUMENT

REASONS FOR ALLOWANCE FOR THE WRIT

1. This case presents important questions of federal law which have not been, but should be, settled by this Court.

When Congress adopted the monumental 1954 Internal Revenue Code, it attempted to minimize the possibility of injustices occurring in the administration of the penalty tax on accumulated earnings, by reversing the burden of proof on the question of whether earnings have been permitted to accumulate beyond the reasonable needs of the business. Sec. 534. In 1955, Congress again indicated its concern by making this provision applicable to all cases pending in the Tax Court, those arising under the 1939 Code as well as under the 1954 Code. Thus on this issue the Commissioner has the burden of proof irrespective of year involved.

Big business has nothing to fear from this penalty tax, unless it be a closely held big business. Widely held businesses are virtually exempt from it. Since most closely held businesses are small business, this tax singles out small business. Knowledge of this fact, plus its traditional protective concern for the encouragement of small business, led Congress to adopt this measure. The

House Ways and Means Committee, which originated the measure, stated this concern (H. Rep. 1337, 83rd Cong. 2d Sess. (1954), p. 52):

> "Your committee has received numerous complaints that this provision is prejudicial to small business, that it has been applied in an arbitrary manner in many cases, and that it is a constant threat to expanding business enterprises. Fear of the penalty tax is said to result frequently in distribution of funds needed by the corporation for expansion or other valid purposes.
>
> "Your committee believes it is necessary to retain the penalty tax on unreasonable accumulations as a safeguard against tax avoidance. However, several amendments have been adopted to minimize the threat to corporations accumulating funds for legitimate business purposes and to restrict the application of the provision in the case of small companies.
>
> "(1) *Burden of proof.* At the present time if the Commissioner of Internal Revenue proposes a deficiency on the ground that the taxpayer has accumulated earnings and profits in excess of the reasonable needs of the business, the taxpayer has the burden of proof as to the reasonableness of the accumulation . . . .
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> • • •
>
> "Under your committee's bill, the taxpayer may . . . file a statement of the grounds . . . . If the taxpayer submits such a statement within the proper time, the burden of proof will be upon the Government as to whether the accumulation is in excess of the reasonable needs of the business."

The Tax Court has been unable to give this unusual remedy any substantial effect. It considered this remedy

at length and concluded that it had no substantial effect, in *Pelton Steel Casting Co.*, 28 T.C. 153 (1957), affirmed on other grounds in *Pelton Steel Casting Co. v. Commissioner*, 251 F. 2d 278 (C.A. 7, 1958), cert. den. 356 U.S. 958. It adhered to this position in *Young Motor Co.*, 32 T.C. 1336 (1959), reversed in *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960). In the present case it did so again, citing and relying on these prior decisions. (R. 96.)

The present case is the most extreme illustration of the Tax Court's failure to give any effect to these amendments of which we have knowledge. The statute imposes a condition precedent to the shift in the burden of proof. This condition is that the taxpayer file with the Commissioner a statement of facts and grounds for the accumulation. Sec. 534(a)(2). The Tax Court thought so little of the significance of the shift in the burden of proof that it did not even make a finding that this condition precedent had been satisfied. The Court of Appeals examined the statement petitioner filed (R. 26-40), and found that the condition precedent had been satisfied (Appendix, p. xii).

At least three Courts of Appeals have disagreed with the Tax Court's view that the shift in the burden of proof is meaningless. *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ....., 61-2 U.S.T.C. 9671, (C.A. 2, Sept. 22, 1961); *Casey v. Commissioner*, 267 F. 2d 26 (C.A. 2, 1959); *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960); and the court below in this case (Appendix, pp. xii-xiii). These appellate court have not agreed among themselves as to what to do about it. In the *Casey* case

and the *Gsell* case, supra, the Tax Court's judgments were reversed; the *Young Motor Co.* case was remanded to the Tax Court for reconsideration in the light of the correct burden of proof; in the present case the Court of Appeals attempted to put itself in the place of the Tax Court and to examine the record in the light of the correct burden of proof. This the court could hardly have been in a position to do completely, since only a portion of the testimony was printed in the record on appeal.[2]

This case illustrates both how the Congressional purpose to provide relief is being frustrated by failure of all courts of appeals to remand to the Tax Court in order that that court will be compelled to try cases in the manner Congress intended, and the probability of injustice if appellate courts do as this one did. First, briefs and arguments on appeal are concerned with points of law, not rearguments of the evidence.[3] Often, as here, much of the evidence will be omitted from the record on appeal. The appellate procedure is therefore not geared to making available to the appellate court the assistance of the attorneys, who often will be familiar with the record from having tried the case, in sifting the evidence. The demands on judges' time make such assistance imperative if they are to do this adequately. Furthermore, the process often does not even bring the entire record before the appellate judges.

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[2]The appellate court correctly stated that in other cases other courts of appeals have also done what it did (Appendix, p. xiii, footnote 4, citing cases).

[3]The Court of Appeals encourages brevity in briefs by limiting them to 80 pages. Rule 18(2)(e), Rules of United States Court of Appeals for the Ninth Circuit.

Second, this case demonstrates that our concern is justified by the event. Both the Tax Court in its opinion (R. 95) and the Court of Appeals in its opinion (Appendix, p. xvi) regarded as the keystone fact

> "the facts, as in this case, show a gross disproportion between the commitments made and prospective benefits to the taxpayer."

To read that statement, one would suppose the record contained evidence showing what the prospective benefits to the taxpayer were. Yet, startling though it appears to us, there is not a speck of evidence in the record to support the quoted statement, and no one who searches the record for it can honestly claim he has found it.[4] Indeed, what evidence there is tends to point the other way. Thus: from the bars in Harolds Club petitioner earned net income of $224,253.89 and $220,371.08 before taxes, in the two years presently involved (R. 76); it invested $927,976.35 (R. 78) in land to provide a site for a new Harolds Club which petitioner would not have to construct; if it did equally well on the bars in the new club it would earn an annual return of 25%, which would be a very good investment indeed.

Any gap in the record on this point should be held against respondent, who had the burden of proving the unreasonableness of the accumulation. Instead, the Tax Court must have drawn inferences from the gaps in the

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[4]We pointed this out to the appellate court once in our brief. Respondent did not reply to our statement. No reference to it was made in the oral argument, which was concerned with points of law. The appellate court evidently overlooked our statement on brief and respondent's failure to reply.

record adverse to the party it thought had the burder (petitioner), and the appellate court seized on the Tax Court's unsupported statement to conclude that no prejudice to us occurred from the Tax Court's erroneous view about location of the burden of proof. This case thus illustrates the dangers in an appellate court's attempting to review the record to guess how the Tax Court would have decided the case had it understood where the burden of proof lay, and represents an excellent vehicle for this Court's study of the problem and administration of appropriate corrective measures.

The importance of the problem is evident from both the attention it twice received from Congress and from the number of cases which have arisen which present it in one form or another. Congress not only adopted legislation shifting the burden of proof in 1954, but thought enough of the problem to work on it again in 1955, when it extended the new provision to cases arising under the 1939 Code. There are numerous cases presenting the problem, as is evident from the fact that the briefs in the lower court referred to 11 such cases in the appellate courts alone, decided in the last four years. The present case is the twelfth. *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ..... (C.A. 2, Sept. 22, 1961), cited above, is another later case.

The numerous appellate court cases do not, unfortunately, advance us far toward clarification of the problem. Although the Tax Court has been affirmed where it has expressed the views it did here, those affirmances have been on the ground that the evidence as a whole supported the decision regardless of where the burden

of proof lay,[5] and none of them to our knowledge has agreed with the Tax Court's emasculation of the 1954 and 1955 legislation. Yet the Tax Court has not admitted the error of its ways and given effect to the Congressional enactments.

Moreover, there is a substantive aspect to the problem under the 1954 Code, present in the instant case, which should be presented in increasing number. This case was the first one in which the Tax Court considered the new credit for reasonably accumulated earnings adopted in the 1954 Code as Section 535(c). The point of this amendment is that even a taxpayer found to have accumulated earnings for the purpose of reducing its shareholders' taxes is entitled to have the taxable corpus reduced by "such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business". In the determination of this credit, the Commissioner has the burden of proof. The Tax Court was thoroughly bewildered by this point. It referred twice (R. 73, 97) to the fact that the Commissioner ignored this issue, but held, in effect, that taxpayer's failure to demonstrate a proper relation between the amount of the investment and the anticipated return was sufficient to carry the Commissioner's burden of proof. This is palpably wrong, but the appellate court failed to correct the error because it assumed erroneously that the Tax Court's statement that there was not a proper relation between amount of investment and anticipated return rested on some evidence in the record.

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[5]As we have demonstrated, this case, where there was no evidence on a point both lower courts thought crucial, illustrates the inadequacy of the appellate process to retry questions of fact.

The first taxable year in which this particular issue can arise is 1954, which explains why this case is the first one to present it. There are certain to be many more.

Accordingly, the problem cannot be expected to simply go away. It will remain until corrected by this Court.

2. The Court of Appeals sanctioned an improper procedure, the effect of which is to nullify a federal statute. Congress intended the shift in the burden of proof to have both meaning and significance. The Court of Appeals held, as have at least two other courts of appeals,[6] that the Tax Court deprived it of real meaning and of all its significance, by trying the case as if the burden of proof had never been shifted to respondent. Contrary to correct procedure, however, the appellate court did not remand the case to the Tax Court with instructions to reassess the case in the light of the correct burden of proof. Instead the Court of Appeals attempted to reassess the case itself.

In failing to remand the case to the Tax Court to reconsider the case and in so doing to apply the burden of proof to the party on whom Congress intended it to fall, the Court of Appeals has sanctioned a nullification of the Congressional enactment. Here was the unusual situation of the party on whom the burden was placed actually standing mute as to one of the issues, that arising in the taxable year 1954 for the first time, yet prevailing.

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[6]That for the first circuit in *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960), and that for the second circuit in *Casey v. Commissioner*, 267 F. 2d 26 (C.A. 2, 1959), and *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ....., 61-2 U.S.T.C. 9671, (C.A. 2, Sept. 22, 1961).

Moreover, respondent offered no evidence tending to establish what return petitioner could expect from the bars in the hotel when completed, yet both the Tax Court (R. 95) and the Court of Appeals (Appendix, pp. xv, xvi) considered the finding of the former court on this point to be essential to the Tax Court's decision; as indeed it was. Yet the finding was wholly without evidence to support it, and must have been a negative inference from the silence of the record, properly drawn only if the petitioner had the burden of proof.

If cases can be tried and decided this way, the shift in the burden of proof is to no avail, and the statute is nullified. This Court should review the case to declare how the statute may be given effect.

3. The Court of Appeals was itself guilty of a departure from proper procedure, which should not be permitted by this Court.

Normal procedure where the burden of proof is misapplied during a trial is to remand to the trial court for reconsideration or, if the case was tried to a jury, for a new trial. *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208 (1939); *Sampson v. Channell*, 110 F. 2d 754 (C.A. 1, 1940), cert. den. 310 U.S. 650 (1940); *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906). The Court of Appeals departed from this salutary rule, and attempted to review the record to determine whether the Tax Court might decide differently on remand. This procedure, in reviewing a pure question of fact, was improper unless, as the Court of Appeals for the Second Circuit recently expressed it,[7] the evidence is convincing

[7] *R. Gsell & Co., Inc. v. Commissioner*, __ F. 2d __, (C.A. 2, Sept. 22, 1961), supra.

that there is no possible justification in the taxpayer's business for the accumulation.

Since there was no evidence at all on what both lower courts regarded as the key point in assessing the reasonableness of the accumulation, it is apparent that there was not convincing evidence.

The Court of Appeals left no doubt either of the importance it attached to this point, or of its assumption that evidence existed to support the Tax Court's statement of fact. The Court of Appeals said:

> "In its opinion the (Tax) Court reasoned that while any benefits received by Harold's Club also benefit petitioner, an expenditure by the latter for the benefit of Harold's Club *could be so out of proportion* to petitioner's capitalization, income and position as an adjunct business that it would be unreasonable for purposes of the petitioner's business as Congress used those words in section 533." (Appendix, pp. xiv, xv.) (Emphasis ours.)

Again:

> "Congress did not want the taxing authorities to be second-guessing the responsible managers of corporations as to whether and to what extent profits should be distributed or retained, unless they were in a position to prove that their position was correct. Casey v. C.I.R., 2 Cir., 267 F. 2d 26, 30. They are in that position, we believe, *when the facts, as in this case, show a gross disproportion between the commitments made and prospective benefits to the taxpayer.*" (Appendix, p. xvi.) (Emphasis ours.)

Plainly the Court of Appeals thought that there were the facts which it stated existed, yet they do not exist.

Neither evidence nor stipulation of facts shows what income petitioner could expect from the bars in the hotel, and unless the expected income were known its proportion to something else must remain a mystery.

The error the Court of Appeals made illustrates the probability of error inherent in permitting the Tax Court to try cases with the burden of proof in the wrong place. This Court should not permit the Court of Appeals to let the error go uncorrected but should review this case as a clear vehicle for illustrating the dangers in departure from correct procedure.

4. The decision below, in holding that the issue in these cases is a mixed question of fact and law (Appendix, p. xiv), conflicts with decisions of another court of appeals, and with two decisions of this Court.

The Court of Appeals agreed, as have others before it, that the Tax Court had erred in its view that the burden of proof was on petitioner (Appendix, pp. xii-xiii). It said, however, that it had a mixed question of fact and law before it, on which it had the right to pass (Appendix, p. xiv). In so holding, the Court of Appeals proceeded contrary to the decisions of this Court in *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943), and in *Helvering v. National Grocery Co.*, 304 U.S. 282 (1938). Also, its decision on this point is contrary to the views of the Court of Appeals for the First Circuit in *Latchis Theatres of Keene, Inc. v. Commissioner*, 214 F. 2d 384 (1954), and *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (1960).

In addition to the conflict on this important point with decisions of this Court and of another court of appeals,

the decision below is in conflict with the logical implications of the statute itself. Obviously, Congress accepted and made no effort to change the view of this Court that the question of unreasonable accumulation was one of fact, for it merely shifted the "burden of proof", a concept pertaining to proof of fact, not persuasion of law.

5. The Tax Court in this case, as in others, found factual support for its decision against petitioner in the circumstances that the corporate income was accumulated instead of distributed, and the shareholder's tax would have been greater had dividends been declared (R. 96). The Court of Appeals agreed that these circumstances were correctly taken into account (Appendix, p. xvii).

The Court of Appeals for the First Circuit, in *Young Motor Co. v. Commissioner,* 281 F. 2d 488, 491, and the Court of Appeals for the Second Circuit, in *R. Gsell & Co., Inc. v. Commissioner,* ..... F. 2d ....., 61-2 U.S.T.C. 9671, both held, reversing the Tax Court, that these circumstances were present in every case where these actions might apply and were neutral, not probative. There is, therefore, a conflict about the effect of these facts between these two circuits and the court below unless there are other facts here to support the Tax Court.

In the paragraph of its opinion where these circumstances and those necessarily implicit in them were recounted, the Tax Court also referred to the facts that petitioner paid no salary to its shareholder (nor did it to any of its officers), and that he had transferred income producing property to it (R. 96). The Tax Court cannot have meant to hold the latter circumstance against petitioner, however, for the transfer was at the time of

petitioner's incorporation (R. 75-76), had a business motivation (R. 75), and no contention was ever made that petitioner was formed to avoid the surtax on its shareholder (R. 90). Moreover, both circumstances were present with respect to the taxable years 1950 and 1952, in which the Tax Court decided favorably to petitioner. These facts cannot logically be compelling in only some of the years.

Accordingly, the Tax Court must have given controlling weight to the circumstances that more taxes would have been paid by its shareholder had petitioner paid dividends, and in affirming the Tax Court the court below rendered a decision in conflict with those of two other courts of appeals.

6. Administration of the law in this area would be aided by clarification by this Court of the meaning of its prior decisions. The reason the Tax Court has had such difficulty in giving effect to these recent statutes is that it considers that they relate only to a subsidiary issue, not to the principal issue. The Tax Court has this difficulty because of the way in which it interprets two decisions of this Court: *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943), and *Helvering v. National Grocery Co.*, 304 U.S. 282 (1938). This Court is the only tribunal with authority to dispel finally the confusion the Tax Court finds between those decisions and effective implementation of the 1954-1955 amendments, so it should review this case for this purpose.

The shift of the burden of proof is on the issue whether the accumulation is within the reasonable needs of the business (Section 534). As the Tax Court interprets the

decisions of this Court cited above, that issue merely creates a presumption against the taxpayer if decided against him and has no significance if decided for him. *Pelton Steel Casting Co.*, 28 T.C. 153 (1957), affirmed on other grounds 251 F. 2d 278 (C.A. 7, 1958), cert. den. 356 U.S. 958; *Young Motor Co.*, 32 T.C. 1336 (1959), reversed 281 F. 2d 488 (C.A. 1, 1960); *Raymond I. Smith, Inc.*, 33 T.C. 141 (1960), disapproved on this point but affirmed in this case below. The result is that in this case the amendments were ignored even to the extent that the required procedural finding was not made.

This Court has not considered the effect the 1954-1955 amendments have, as they were enacted years after the decisions referred to were rendered. We believe that ultimately this Court must consider and decide what effect these amendments have in the light of its earlier decisions. The instant case is a strikingly appropriate vehicle.

7. If certiorari is granted, the Court may desire to consider certain provocative aspects of this case either entirely or partly substantive in nature.

a. The Tax Court found as a fact that two of the three members of petitioner's board of directors considered that "no dividend should be paid . . . because of the obligations then existing, including the obligation on the purchase price of the land . . ." (R. 89). Since the directors made petitioner's decisions for it, this finding amounts to a finding explaining why petitioner did not pay dividends. Yet the Tax Court held, inconsistently with this finding (R. 97), that petitioner paid no dividends because of a purpose to avoid the surtax on its shareholders.

This Court may wish to consider whether the Tax Court can ignore admittedly truthful testimony explaining the failure to pay dividends in deciding why dividends were not paid.

b. Petitioner actually acquired the land in question, going deeply into debt to do so. Accordingly, as the Tax Court acknowledged (R. 91), this case involves an actual acquisition, not mere reserves for planned future acquisitions. Petitioner and Harolds Club, the Tax Court also found (R. 87-88), "realized that the development of the farm land could not be started until they could accumulate additional earnings in view of the $17,000,000 estimate, the fact that a part of the purchase price of the land had not been paid, (etc.)." Yet the Tax Court appears to have considered the failure of petitioner and Harolds Club to begin construction of the hotel-casino by trial time as some evidence of the interdicted purpose (R. 94-96).

This Court may wish to consider whether insufficiency of accumulations on hand to accomplish the corporate purpose without further accumulations makes the accumulation of the inadequate funds improper and taxable.

c. The Tax Court appears to have assumed the authority to impose this penalty tax if it considers that a business investment is not going to be as profitable as the Tax Court considers proper (R. 95-96), and the Court of Appeals has approved what the Tax Court has done (Appendix, p. xvi).

This Court may wish to consider whether the Tax Court may, under the guise of determining the "purpose" (Sections 532, 533, 534) on which the imposition of the

penalty tax depends, create standards of proper profitability.

CONCLUSION

The writ of certiorari should issue.

Dated, San Francisco, California,
October 25, 1961.

Respectfully submitted,

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(Appendix Follows.)